BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

6 June 2025

The Headlines

- The US unemployment rate remained at 4.2%, but year-to-date nonfarm payroll growth slowed to 124,000 per month, the slowest pace since the Global Financial Crisis.
- The United States doubled tariffs on steel and aluminum imports to 50%, signaling ongoing trade tensions and the likelihood of further sectoral tariffs.
- In China, the Caixin Manufacturing PMI dropped sharply, reflecting pressure from higher US tariffs, while official PMIs remained stable.
- The Eurozone saw headline inflation fall below expectations, driven by lower energy prices and a strong euro, with core inflation at its lowest since early 2022.
- The European Central Bank cut rates by 25 basis points, signaling a near end to its easing cycle.
- Looking ahead, US CPI inflation is expected to rise due to tariffs, while China's export growth is projected to slow and inflation metrics to remain in deflation.

The Week Behind

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Job Openings	3 June	April	Level	7.1 million	7.4 million	7.2 million
	Unemployment Rate	6 June	May	Level	4.2%		4.2%
	Nonfarm Payroll Growth	6 June	May	m-o-m	126,000	139,000	147,000
	Two-month Payroll Net Revision	6 June	March–April		-95,000		-58,000
Eurozone	Headline HICP	3 June	May	y-o-y	2.0%	1.9%	2.2%
	Core HICP	3 June	May	y-o-y	2.4%	2.3%	2.7%
	ECB Deposit Rate	5 June		Level	2.00%	2.00%	2.25%

The Week Ahead

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	CPI	11 June	May	y-o-y	2.5%		2.3%
	CPI	11 June	May	m-o-m	0.2%		0.2%
	Core CPI	11 June	May	y-o-y	2.9%		2.8%
	Core CPI	11 June	May	m-o-m	0.3%		0.2%
China	CPI	8 June	May	y-o-y	-0.2%		-0.1%
	PPI	8 June	May	y-o-y	-3.0%		-2.7%
	Exports	8–9 June	May	y-o-y	6.0%		8.1%
	Imports	8–9 June	May	y-o-y	-0.9%		-0.2%

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The Week Behind

1. US labor market reports showed marginal deterioration.

The outlook: The US labor market was already showing signs of fragility before trade tensions rose. I expect further labor market weakening as economic uncertainty remains elevated and significantly higher tariffs lead companies to seek ways to reduce costs to limit price increases.

The details: The Job Openings and Labor Turnover Survey (JOLTS) indicated that job openings rose to a stronger-than-expected 7.4 million in April from 7.2 million in March. Despite the marginal increase in unfilled positions, the ratio of open jobs to unemployed workers remained at 1.0x. The quit rate slipped in April to 2.0% from 2.1% while the hire rate nudged higher to 3.5% from 3.4%.

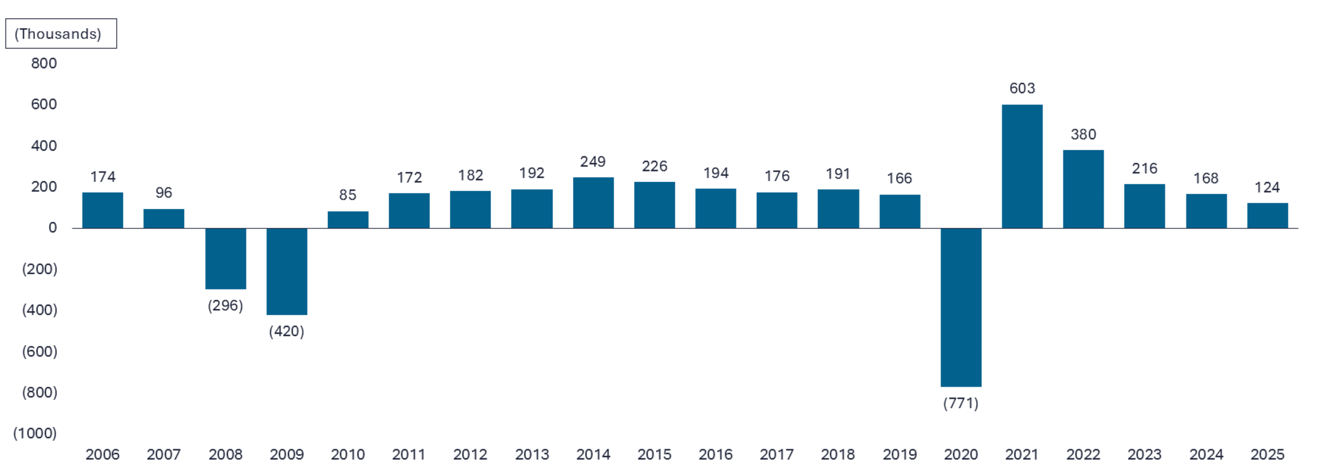
The Employment Situation report showed that nonfarm payrolls grew by 139,000 in May versus a downwardly revised 147,000 in April and compared to the consensus expectation of 126,000. With a 95,000 negative revision to the prior two months of data, the average monthly nonfarm payroll growth declined to 124,000 year-to-date (YTD), the lowest level since the Global Financial Crisis.

Worryingly, despite the weakness in the YTD payroll growth, average hourly earnings rose more than expected with increases of 3.9% year-on-year (y-o-y) and 0.4% month-on-month (m-o-m). The consensus expectation was for increases of 3.7% y-o-y and 0.3% m-o-m the prior month. While I am always happy for American workers to earn more, the risk could be that workers are demanding higher wages in anticipation of tariff-induced inflation at the same time employers are refraining from hiring to minimize costs to offset price pressures caused by tariffs. This uncomfortable combination presents a dilemma for the Federal Reserve as its mandate to maximize employment would seem to call for lower rates, but rising wage pressures argue against easing policy.

The unemployment rate remained stable at 4.2% in part due to a fall in the labor force participation rate to 62.4% from 62.6%. The employment-to-population ratio (the percentage of noninstitutionalized adults who work) fell to 59.7% from 60.0%.

Year-to-Date US Job Creation Has Slowed to the Lowest Level since the Global Financial Crisis

Average Monthly Change in Private Nonfarm Payrolls



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Source: Bureau of Labor Statistics, Haver Analytics
Note: As of May 2025

2. **The United States doubled tariffs on steel and aluminum to 50% effective 4 June.**

The outlook: This tariff increase is a reminder that even if the Trump administration cannot necessarily rely on using the International Emergency Economic Powers Act (IEEPA) to impose tariffs, it still has wide latitude to impose tariffs under other legal auspices such as Section 232 in this case. We continue to expect additional sectoral tariffs related to semiconductors, pharmaceuticals, copper, and lumber. In our view, even if the initial Court of International Trade ruling is upheld that the use of IEEPA is illegal for the imposition of tariffs, the US administration is likely to use other legal provisions such as Sections 122, 232, 301, and 338 to impose comparable levels of tariffs.

The details: In 2024, US imports of steel and aluminum totaled ~$61 billion which represents just under 2% of total imports. Hence, the increase from 25% to 50% on all imports except those from the United Kingdom until at least 9 July increased the weighted average US tariff rate on imports by about 50 basis points (bps).

3. **China's Caixin Manufacturing Purchasing Managers' Index (PMI) fell sharply while other PMIs were stable.**

The outlook: China's PMI readings have been relatively stable in recent months at levels near the demarcation between contraction and expansion. However, I expect the manufacturing readings to deteriorate as the year progresses and much higher US tariffs continue to bite. While manufacturers are likely to seek other outlets to export their goods, they will likely be challenged by the reluctance of other countries to allow excess supplies from China to undercut domestic competitors.

The details: The National Bureau of Statistics (NBS) PMIs were relatively stable perhaps reflecting in part their focus on larger, state-owned enterprises in China. The Caixin PMIs have a higher representation of export-oriented, privately owned companies and tend to be more volatile. The decline in the Caixin Manufacturing PMI should not be a surprise in that regard given the trade war.

April China PMI Data

Release Date		Consensus	Actual	Prior Month
5/30/2025 NBS	Manufacturing	49.5	49.5	49.0
	Non-Manufacturing	50.5	50.3	50.4
	Composite	*	50.4	50.2
6/2/2025 Caixin	Manufacturing	50.7	48.3	50.4
6/4/2025	Services	51.0	51.1	50.7
6/4/2025	Composite	*	49.6	51.1

Source: Bloomberg, China Federation of Logistics & Purchasing, S&P Global
* No consensus estimate available on Bloomberg.

4. **The Eurozone Harmonized Index of Consumer Prices (HICP) inflation was lower than expected.**

The outlook: European inflation continues to subside due to a combination of euro strength, falling energy prices, and a more sustainable deceleration of services inflation. I expect Eurozone inflation to remain at or below the 2% target through year end and into 2026 absent a shock to energy prices.

To the extent I am correct in expecting more trade friction between the United States and European Union, inflation could be lower than expected.

The details: Core inflation was the lowest since January 2022 with services inflation falling to the lowest level since March 2022. At a headline level, a 3.6% decline y-o-y in energy prices partially offset a 3.3% increase in food prices. (Food has a weight of 19.3% in the headline inflation index versus energy at only 9.4%.)

At a country level, the lowest headline inflation was in Cyprus at 0.4% y-o-y and France at 0.6% y-o-y, while the highest inflation was in the Baltics at ~4.0% y-o-y and the Netherlands at 3.0% y-o-y.

5. **The European Central Bank (ECB) eased by 25 bps as expected. ECB President Christine Lagarde repeatedly asserted that the ECB is in "a good place" leading markets to expect less future easing.**

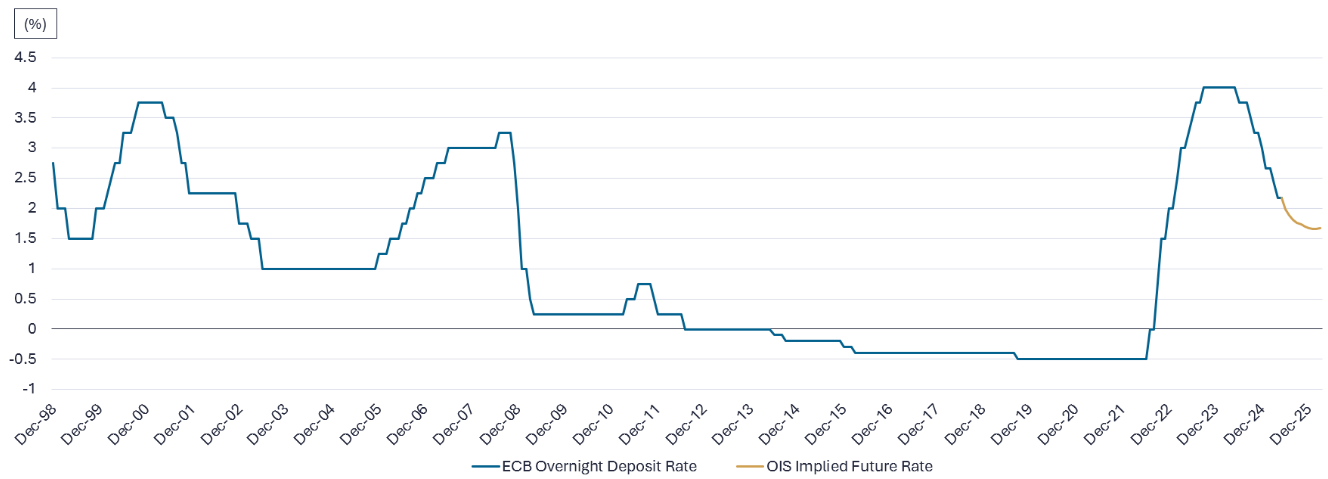
The outlook: In her remarks, Lagarde indicated that an escalation of the trade conflict with the United States and potential EU retaliation are not part of the ECB's baseline scenarios regarding future monetary policy moves. Hence, her comments about being in "a good place" should be taken in context. Markets are pricing one more rate cut by year end, but I expect two reductions assuming a more aggressively antagonistic US trade stance against the European Union moving forward.

The details: One member of the ECB Governing Council voted against the 25-bps rate cut, presumably preferring to pause. While she did not offer forward guidance, the messaging from Lagarde seemed clear. The ECB is nearing the end of the easing process and is approaching neutral monetary policy. Lagarde indicated the level of neutrality was not discussed at this ECB meeting, but she also noted that any concept of neutral policy is predicated on an environment without economic shocks, a condition the Eurozone has not enjoyed for over five years.

In the ECB staff economic forecasts, headline HICP forecasts for 2025 and 2026 were reduced by 0.3% to 2.0% and 1.6%, respectively. The forecast for 2027 was left unchanged. The primary drivers of decreased inflation expectations were lower energy prices and a stronger euro which are assumed to persist when the staff updates expectations.

Markets Suggest ~32 bps of Additional ECB Rate Cuts through 2025*

Implied Eurozone Deposit Rate through March 2026



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Source: Bloomberg
Note: As of 5 June 2025
* Markets imply a 42% chance of a 25-bps rate cut at the July meeting and an 84% chance of an additional 25-bps cut at the September meeting.

The Week Ahead

1. **US Consumer Price Index (CPI) inflation is expected to begin grinding higher in May due to tariffs.**

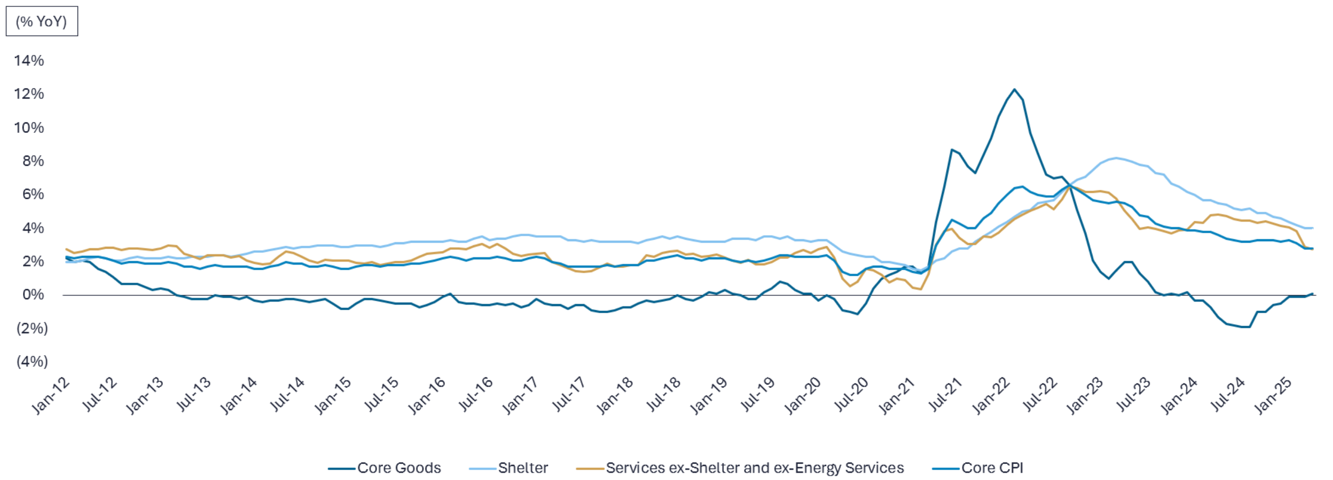
   <u>The outlook:</u> After reaching a cyclical trough in April, I expect the May CPI report to begin reflecting upward pressure on goods prices due to tariffs. While different goods categories will respond to tariffs in different ways at different times, we can assume that inventories accumulated late in 2024 and early in 2025 before tariffs were increased have likely been exhausted in many cases. While companies are carefully avoiding attracting attention by announcing price increases or highlighting that they are a result of tariffs, they have to choose between raising prices to protect margins, cutting other costs to offset tariffs, or suffering lower margins and a weaker share price.

   I will be watching for core goods inflation (all physical products other than food and energy) to see if tariffs are leading to higher consumer prices. Over time, I will also be watching to ensure that rising goods prices do not cause higher wage demands in the service sector that then translate to increase prices for activity not directly affected by tariffs. I view this transmission to services as being unlikely given that I expect the US economy and labor market to weaken further this year limiting workers' bargaining power and the risk of a more sustained increase in inflation.

   Given this view, I do not expect the Fed to raise rates in response to tariff-induced inflation, but I also do not anticipate any rate cuts against a backdrop where core inflation is likely to rise to levels around 4%.

US Core CPI Inflation Is Likely to Reaccelerate after Hitting a Cyclical Trough in April

US Consumer Price Index Inflation for Key Categories



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Source: Bureau of Labor Statistics, Haver Analytics
Note: As of April 2025
Core goods represent ~24% of core CPI, shelter represents ~44%, and services ex-shelter and ex-energy services represent ~32%.

2. **China's export growth is expected to weaken in May with imports falling y-o-y.**

   <u>The outlook:</u> China is expected to report that export growth slowed in May to 6.0% y-o-y from 8.1% in April. Imports, which typically signal future export volume, are expected to decline 0.9% y-o-y versus a fall of 0.2% in April. Given recent data regarding US goods imports, it is likely that exports to the United States will fall substantially versus the prior year while exports to other countries are expected to increase as China manufacturers seek alternative end markets.

3. **China CPI and Producer Price Index (PPI) inflation metrics are expected to remain in deflation.**

   <u>The outlook:</u> China's CPI inflation is expected to remain slightly in deflationary territory at -0.2% y-o-y in May versus -0.1% in April, marking the 28th consecutive month of CPI at or below 1%. PPI is expected to be in deflation for the 32nd consecutive month as production continues to far exceed levels that can be absorbed by domestic demand.

   Absent some combination of a positive breakthrough in US trade negotiations, a major domestic fiscal stimulus, and major structural economic reforms, I expect China's economy to remain weak.